FISCAL NOTE

Bill #: **HB0655**

Title: **Flat tax for income tax**

Primary Sponsor: **Joe Tropila**

Status: **As introduced**

Sponsor signature Date

Dave Lewis, Budget Director Date

Fiscal Summary	**FY2000 Difference**	**FY2001 Difference**
Expenditures:		
General Fund	$240,000	($193,000)
Revenue:		
General Fund	$0	$125,532,000
Net Impact on General Fund Balance:	**($240,000)**	**$125,725,000**

Yes	**No**		**Yes**	**No**	
	X	Significant Local Gov. Impact	X		Technical Concerns
	X	Included in the Executive Budget	X		Significant Long-Term Impacts

Fiscal Analysis

ASSUMPTIONS:

Individual Income Tax

1. This proposal applies to tax years beginning after December 31, 1999 (tax year 2000). There is no revenue impact from this proposal in FY2000.
2. Under this proposal, state tax liability for individual income taxpayers would be a flat percentage of the taxpayer's adjusted federal tax liability. Taxpayers would make adjustments to federal taxable income for interest income on obligations of the U.S. government; railroad retirement benefits; exempt tribal income; veteran's bonus payments; salaries of active duty servicemen; unemployment compensation; tip income; contributions to medical care, first-time homebuyer, and education savings accounts; certain sub-S shareholder income; and interest on non-Montana local government bonds to arrive at adjusted federal taxable income. Adjusted federal taxable income would then be used to calculate adjusted federal tax liability. State tax liability would then be calculated as 34% of adjusted federal tax liability.
3. Total federal tax liability before credits for full-year residents is forecast to be $1,637,856,000 for tax year 2000. Total federal credits taken for tax year 2000 are forecast to be $37,000,000. The tax rate of 34% provided for in the bill, when applied to federal liability net of credits, increases tax liability of Montana

residents by $125,532,000 in tax year 2000. A tax rate of 26.2% would be revenue-neutral for tax year 2000.

Administrative Impacts

4. There will be one-time administrative expenses associated with reconfiguring the individual income tax and corporation license tax computer systems to conform to the new format of tying to federal tax liability. The department intends to replace its existing individual income tax system, and, therefore, will make only those modifications minimally required to implement this legislation. These one-time costs to modify the system are estimated to be $175,000 in FY2000. Changes to the corporation license tax system would require an additional $65,000 of administrative expense.
5. The department will have administrative savings of $193,000 in FY2001. This is due to elimination of the current long and short form tax returns; having to process fewer income tax returns; reduced mail handling; reduced data entry exceptions; reduced computer storage costs; and lowered cost of processing refunds. These ongoing cost reductions reflect reductions in internal contracted services. There are no anticipated cost savings in the audit program of the agency.

FISCAL IMPACT:	FY2000 Difference	FY2001 Difference
Expenditures:		
Operating Expenses	$240,000	($193,000)
Funding:		
General Fund (01)	$240,000	($193,000)
Revenues:		
General Fund (01)	$0	$125,532,000
Net Impact to Fund Balance (Revenue minus Expenditure):		
General Fund (01)	($240,000)	$125,725,000

LONG-RANGE IMPACTS:

The on-going administrative savings would carry on in future years. Revenues in future years would be very closely tied to future federal tax reform.

TECHNICAL NOTES:

1. The bill, in several sections (Sections 1 and 24), refers to “adjusted federal gross income” a term not defined in the bill. Is this intended to mean federal adjusted gross income (FAGI)?
2. The bill was prepared without the benefit of any prior analysis estimating a revenue-neutral rate for tax year 2000. Consequently, the rate in the introduced bill results in a very large revenue increase. It is understood that that was not the intention of this proposal. Amendments to reduce the rate to 26% would produce a revenue impact that is closer to being revenue-neutral.
3. Section 32(1) of the bill provides that the taxpayer may reduce federal adjusted gross income for contributions to a medical savings account. This should be changed to federal taxable income, as was done for the deductions for the first-time homebuyer and education savings accounts.
4. New Section, Section 3, provides a somewhat limited definition of in-state income for nonresidents. Under this definition, for example, lottery winnings would not come within the language.